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FARM BUSINESS FINANCIAL STRESS

A Challenge For Extension

by

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ABSTRACT

Recent studies have assessed the current "farm crisis" in terms of meeting near-term cash needs and portray a problem of limited proportions. This study changes the perspective to the intermediate and longer run and stresses profitability. Results suggest that through this perspective the "farm crisis" is worse than reported in other recent literature and presents a challange to Extension.

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The economic decline that has gripped the U.S. farm economy for the past five years continues unabated. Increasing farm loan delinquencies and foreclosures evidence the growing degree of financial ill-health on U.S. farms (Wilkinson; USDA, December 1985). Recent studies conclude that ten to fifteen percent of all farms and fifteen to twenty percent of commercial farms are experiencing financial stress (USDA, July 1985; FAPRI; Melichar, 1985). Extension Agents and Specialists, on the other hand, have been reporting a greater degree of farm financial and family discord than is suggested--particularly in certain regions of the country.

Farmers Disquise Financial Stress

During periods of low receipts farm families employ a variety of strategies to conserve and generate cash, that in effect disquise farm business financial problems. They transfer income from other sources, reduce inventories, reduce payment for family labor, and delay replacement of capital assets. Because the economic distinction between the farm business and the farm household is often blurred, previous studies commonly emphasized "family" rather than "business" cashflow, as a proxy for "farm financial stress". However, a positive cashflow, business or family, does not mean a farm business has paid all of its expenses and is in good financial health. Hidden costs (depreciation and unpaid family labor) and subsidization (off-farm income and inventory reduction) can mask poor financial health. By focusing attention on "family" cashflow recent studies failed to remove that mask and have likely understated the extent and degree of farm business financial strife in the U.S.

Extension Sees Through The Disquise

Primary among its responsibilities, the Cooperative Extension Service (CES) is charged with improving the social and economic well-being of farm families. Success in fulfilling that responsibility will, in large part, be determined by how CES perceives the current and future prospects for financial health of U.S. farm businesses. That perception depends upon CES´s ability to see through the mask of "family cashflow" and unveil the reality of farm business financial health. CES has not been idle and is to be complimented for it early recognition of and response to the situation. Responsiveness, a "hallmark" of CES, is being tested and wearing well. Armed with documented "limited farm family financial stress" and a perception that "business" stress was likely worse, CES has redirected existing resources and targeted new resources to expand farm family business management education programs. However, the question remains--"How deep and widespread is the financial ill-health of U.S. farm businesses?" The answer is crucial to CES as it allocates limited resources among competing programs.

Removing The Mask--Focus On the Business

A true picture of farm business financial health is only revealed by isolating the business in terms of income and expenses and examining liquidity, solvency, and profitability indicators. Off-farm income was excluded in the analysis. All farm expenses, including unpaid family labor and depreciation, were paid and changes in inventory were accounted for.

Consideration was given to (1) the ability of a business to meet its short-term financial obligations (liquidity), (2) the riskbearing capability of the business (solvency), and (3) the long-run survivability of the business (profitability).

Using data from nearly 13,000 farm businesses of all types and sizes throughout the U.S. (commonly referred to as the USDA's 1984 Farm Costs and Return Survey) farms were classified into financial health categories using subjective common rules-of-thumb. Liquidity, solvency, and profitability of a farm business, respectively, were assumed satisfactory if: (1) shortrun cash requirements (i.e. operating operating expenses, operator labor charges, and principal payments) were satisfied, (2) debt-to-asset ratio did not exceed .5, a commonly accepted maximum for many lenders, and (3) rate of return on assets was not less than .04, the average long-term current return to farm assets (Melichar, 1979). Acceptable profitability was always preferred in the financial health category ranking scheme since, it implies an ability to correct unacceptable cash balances and/or debt-to-asset ratios. Positive cash balances were preferred, regardless of debt-to-asset ratio, because current expenses had been met without incurring additional debt.

The analysis reveals a dimension of the farm crisis heretofore not publicly recognized and demonstrates that farm "business" financial stress in the U.S. is a problem of much greater degree and proportion than commonly acknowledged. Nearly seventy percent of all farm businesses exhibited poor financial health (categories 6 to 7) and only twenty percent exhibited good good financial health (categories 0 and 1). Using "all farms" as the base, however, does not accurately depict the incidence and degree of financial stress on commercial farms. It can be argued that the standards and ranking scheme used in the analysis--is inappropriate for small farms since household and farm business activities are, even in the best of times, not considered as independent activites. Restricting the analysis to commercial farms (those with at least $40,000 gross income) resulted in forty percent of the farm businesses being classified in poor financial health and another forty percent as good, a significant improvement. Larger commercial farms exhibited still further improvement in financial health. Over half of the largest commercial farms ($250,000 or more gross income) had good financial health while one-fourth were in poor condition.

CES Perception Confirmed/Challenge Presented

While confirming CES's perception that the farm financial crisis was worse than described, this study suggests that the stress is likely even greater than CES imagined. It's likely that forty and possibly even fifty percent of commercial farms in the U.S. are not financially sound, albeit much of it disguised by farmers themselves. Figures of this magnitude present a clear challenge to CES. Acceptance of the reality and magnitude of the current farm crisis demands action on the part of CES. Continued priority setting and shifting of resources to facilitate the development and implementation of longer-run educational programs that address the protracted financial ill-health problem that permeates the U.S. farm sector is a must. It comes at time when CES is engaged in other critical organizational, political, and funding challenges that may detract from the efforts needed to deal with the problem at hand. However, it does provide a timely opportunity for CES to test its resolve to concentrate resources in critical education programs, improve its performance, and, in the eyes of some, restore its legitimacy as a "change agent" in fulfilling its responsibility to improve the social and economic welfare of farm families.

Resources, Sensitivity, and Hard-Nosed Economics

Educational programs that address the problem will require well-trained personnel, investment capital, perseverance, a sense of mission, and a sensitivity to individual, family, business, and community capabilities and objectives. However, CES must be forthright, realistic, and hard-nosed with respect to economic considerations for these same entities. A fully integrated effort by Home Economics, Farm Management, and 4-H will be critical. Programs should explicitly focus on the profitability of the farm and assist families in understanding and implementing the principles of profitable farm business management. Families (spouses and children) need to be aware of the implications of: (1) not having adequate land, labor, capital, and/or management, (2) subsidizing the farm business with off-farm income and/or unpaid family labor, and (3) living off of depreciation. CES must openly accept the responsibility to help families examine the adviseability and consequences of, so to speak, "mother teaching school to provide family necessities while father pays for the privilege of being a farmer through low, zero, or even negative wages." Heretical as it may seem, CES has a responsibility to assist some families out of farming. Simultaneously, for those families that can realistically expect to operate a profitable business or decide to continue subsidizing an unprofitable operation, CES needs to concentrate resources to help them look beyond family cashflow to a better understanding, attainment, and maintenance of sound farm business financial health.

Table 1. MEASURES OF FARM FINANCIAL HEALTH
LEVELS OF ACCEPTABILTY

Measure	Acceptable Level
Liquidity	
Cash Balance	$0 or Greater
Solvency	
Debt-to-Asset Ratio	.5 or Less
Profitability	
Return on Assets	4% or Greater

Table 2. FARM FINANCIAL HEALTH CATEGORY DETERMINATION

Acceptability of Measure			Financial Health
Liquidity	Solvency	Profitability	Category
Yes	Yes	Yes	0 (best)
Yes	No	Yes	1
No	Yes	Yes	2
No	No	Yes	3
Yes	Yes	No	4
Yes	No	No	5
No	Yes	No	6
No	No	No	7 (worst)

Table 3. FARM BUSINESS FINANCIAL HEALTH
U.S. FARMS - JANUARY 1985

Financial Health Category	All Farms	Gross Income At Least $40,000	Gross Income At Least $100,000	Gross Income At Least $250,000
	- - - - -	Percent of farms 1/	- - - - -	
0 (best)	15	31	35	42
1	4	7	10	13
2	1	3	4	5
3	2	4	5	6
4	10	14	10	6
5	*	*	*	*
6	59	29	25	19
7 (worst)	9	11	11	9

* Less than 1 percent
1/ Percentages may not add to 100 due to rounding

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